

FDIC State Profile

Fall 2005

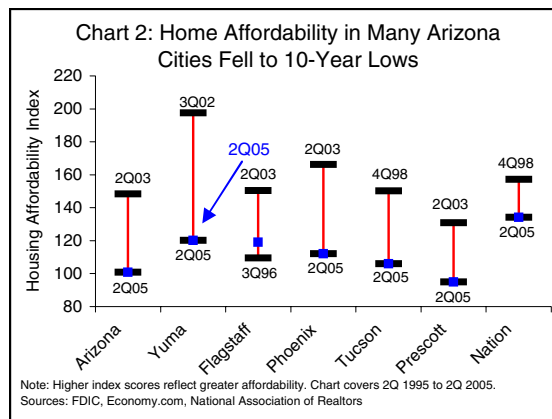
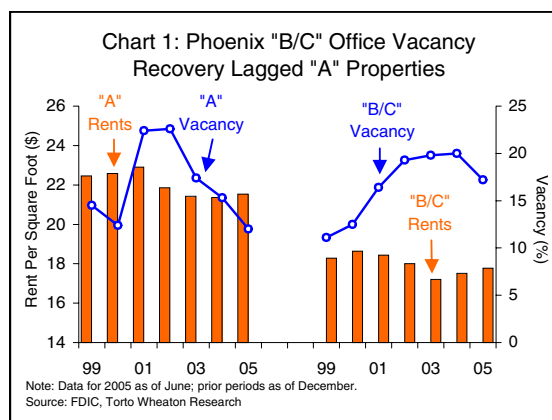
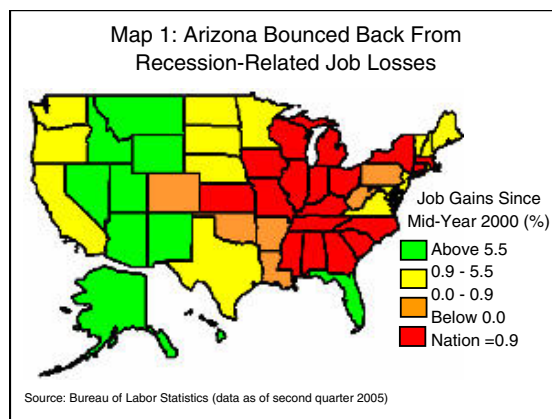
Arizona

Arizona bounced back from recession-related job losses and now faces a bright future.

- Although Arizona lost over 20,000 jobs during and after the 2001 recession, the state surpassed its pre-recession employment peak by year-end 2002 (see Map 1).
- Solid population growth, as well as job gains in the construction, retail, and health services sectors, was key to the state's recovery. Together, these sectors generated more than half of the net new jobs since 2001.
- Annual job gains in Arizona moderated slightly between the first and second quarters of 2005. However, job growth ranked second only to Nevada, due to expansion in the construction and consumer services sectors.
- Forecasts indicate continued vigor for Arizona job growth through 2005, with some moderation in 2006.¹
- Recent hurricanes likely will have indirect implications for the Arizona economy. Post hurricane reconstruction in the Southeast may create labor and construction supply pressures. Moreover, energy price increases may have some adverse effects on consumer demand, including travel and tourism.

Arizona employment gains drove improving commercial real estate (CRE) conditions.

- **Phoenix** office and industrial vacancies improved through June 2005 as strong absorption pushed vacancies to four-year lows.² In Phoenix, rents in both "A" and "B/C" offices buildings improved. However, vacancies remain high in "B/C" office properties (see Chart 1).³
- CRE loans continued to climb at Arizona-based institutions. At second quarter 2005, insured institutions in both the state and **Tucson** ranked first in the nation for the highest median CRE to Tier 1 capital ratios.
- Arizona also ranks first in the nation for a concentration of construction and development (C&D) loans to Tier 1



¹Forecast source is Economy.com.

²According to Torto Wheaton Research.

³Class "A" properties are generally newer with better quality construction and location.

State Profile

capital of 171 percent versus a national median of 31 percent. At 206 percent, Tucson ranks eighth among major markets.

House prices took off as speculative activity boomed.

- Second quarter home prices jumped 28 percent on an annual basis in Arizona, compared to 13 percent nationally; and grew 30 percent and 22 percent in Phoenix and Tucson, respectively.⁴ Second quarter housing affordability declined to decade lows throughout most of Arizona (see Chart 2).⁵
- In first half 2005, residential mortgage activity in the state of Arizona was characterized by active levels of investor participation and use of innovative mortgage products, even among non-prime borrowers. For example, 26 percent of Alt-A (low documentation) Arizona mortgages were to investors compared to 18 percent for the nation. In addition, innovative (option ARM and interest only) mortgages accounted for 53 percent of subprime and Alt-A mortgages securitized in Phoenix compared to 44 percent for the nation.⁶

Bankruptcy filings are on the radar.

- Personal bankruptcy filings spiked 15 percent in Arizona year-over-year because of pending bankruptcy law changes. Filings exceeded the nation on a per capita basis and were higher than pre-recession levels (see Chart 3).
- Past-due consumer loans at Arizona institutions were near historical lows. However, should interest rates rise or hurricane-related energy price hikes persist, institutions could experience an uptick in consumer loan defaults.

Net interest margins and profits rebounded.

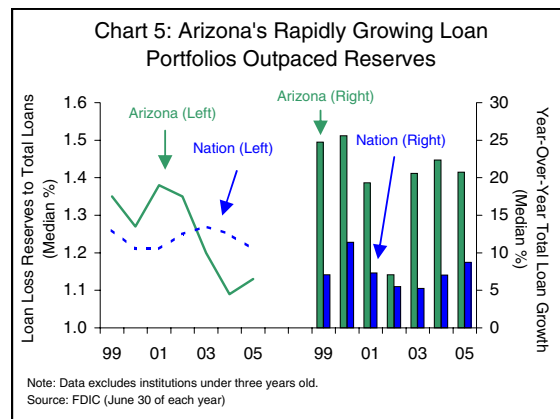
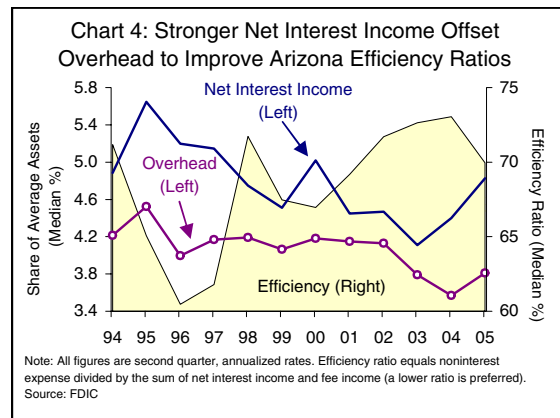
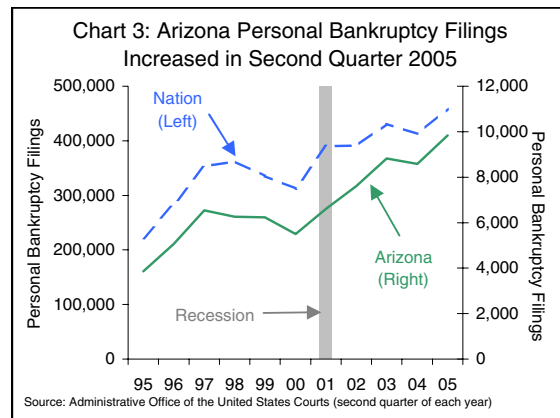
- Widening margins significantly benefited second quarter pre-tax earnings and efficiency ratios among Arizona-based institutions (see Chart 4).⁷ Profits increased despite rising overhead and provision expenses.
- Although improving, the median efficiency ratio in Arizona (the share of net operating revenues absorbed by overhead expenses) still ranked seventh worst in the nation, in part because of the high proportion of new institutions.

Past-due loans hit historical lows.

- Arizona insured institutions continued to report one of the lowest past-due loan levels in the nation as of second

quarter 2005. Excellent economic conditions, low interest rates, and strong loan growth aided credit quality.

- Loan growth among Arizona institutions remained second nationwide; C&D loans and home equity lines of credit, two higher-risk categories, led the growth.
- Although improving, loan loss reserves relative to total loans remained near historical lows and lagged the nation (see Chart 5). Rapid growth in higher-risk loan segments may pressure reserve levels as loans season, particularly if interest rates rise and home appreciation slows.



⁴Office of Federal Housing Enterprise Oversight.

⁵According to Economy.com and National Association of Realtors.

⁶Based on LoanPerformance data.

⁷The efficiency ratio equals noninterest expense (overhead) divided by the sum of net interest income and fee income.

Arizona at a Glance

ECONOMIC INDICATORS (Change from year ago, unless noted)

Employment Growth Rates	Q2-05	Q1-05	Q2-04	2004	2004
Total Nonfarm (share of trailing four quarter employment in parentheses)	3.9%	4.1%	3.3%	3.4%	1.4%
Manufacturing (7%)	0.1%	0.7%	0.1%	0.3%	-4.5%
Other (non-manufacturing) Goods-Producing (9%)	11.3%	10.3%	7.6%	7.7%	1.8%
Private Service-Producing (67%)	3.8%	4.1%	3.7%	3.6%	2.2%
Government (17%)	2.3%	2.9%	1.0%	1.8%	0.8%
Unemployment Rate (% of labor force)	4.7	4.4	5.1	5.0	5.7

Other Indicators	Q2-05	Q1-05	Q2-04	2004	2004
Personal Income	8.6%	8.8%	9.9%	8.3%	5.3%
Single-Family Home Permits	5.7%	8.5%	25.3%	20.9%	15.5%
Multifamily Building Permits	5.6%	70.0%	17.4%	8.7%	-8.4%
Existing Home Sales	6.7%	22.5%	19.7%	24.9%	16.7%
Home Price Index	27.8%	20.4%	10.3%	12.3%	5.8%
Bankruptcy Filings per 1000 people (quarterly annualized level)	6.77	5.08	6.08	5.48	6.84

BANKING TRENDS

General Information	Q2-05	Q1-05	Q2-04	2004	2004
Institutions (#)	51	51	49	49	50
Total Assets (in millions)	74,020	69,859	52,921	59,321	60,773
New Institutions (# < 3 years)	12	12	13	10	13
Subchapter S Institutions	7	7	6	7	6

Asset Quality	Q2-05	Q1-05	Q2-04	2004	2004
Past-Due and Nonaccrual Loans / Total Loans (median %)	0.20	0.40	0.42	0.37	0.56
ALLL/Total Loans (median %)	1.12	1.08	1.07	1.06	1.17
ALLL/Noncurrent Loans (median multiple)	6.05	4.36	3.76	3.46	3.34
Net Loan Losses / Total Loans (median %)	0.00	0.00	0.00	0.00	0.03

Capital / Earnings	Q2-05	Q1-05	Q2-04	2004	2004
Tier 1 Leverage (median %)	9.54	9.78	9.85	10.27	9.90
Return on Assets (median %)	1.17	1.11	0.90	0.99	0.88
Pretax Return on Assets (median %)	1.54	1.40	1.07	1.13	1.16
Net Interest Margin (median %)	5.29	5.11	4.76	5.09	4.66
Yield on Earning Assets (median %)	6.97	6.53	5.97	6.26	5.98
Cost of Funding Earning Assets (median %)	1.82	1.53	1.18	1.28	1.30
Provisions to Avg. Assets (median %)	0.23	0.19	0.17	0.17	0.28
Noninterest Income to Avg. Assets (median %)	0.53	0.54	0.63	0.53	0.70
Overhead to Avg. Assets (median %)	3.81	3.71	3.57	3.68	3.74

Liquidity / Sensitivity	Q2-05	Q1-05	Q2-04	2004	2004
Loans to Assets (median %)	75.6	74.6	74.3	76.4	69.4
Noncore Funding to Assets (median %)	14.7	14.8	15.3	15.7	15.3
Long-term Assets to Assets (median %, call filers)	4.4	4.6	6.7	5.2	7.8
Brokered Deposits (number of institutions)	28	26	23	26	21
Brokered Deposits to Assets (median % for those above)	6.9	7.2	7.6	7.2	7.1

Loan Concentrations (median % of Tier 1 Capital)	Q2-05	Q1-05	Q2-04	2004	2004
Commercial and Industrial	112.2	112.2	110.0	114.0	110.9
Commercial Real Estate	486.8	443.4	399.9	462.3	385.9
<i>Construction & Development</i>	170.7	160.0	129.4	140.2	104.6
<i>Multifamily Residential Real Estate</i>	5.8	5.7	7.6	6.7	4.1
<i>Nonresidential Real Estate</i>	254.2	255.7	235.8	238.2	230.5
Residential Real Estate	80.4	81.5	89.1	89.1	76.4
Consumer	9.9	10.6	12.2	12.7	14.0
Agriculture	0.0	0.2	0.0	0.0	0.0

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
Phoenix-Mesa-Scottsdale, AZ	63	43,717	< \$250 million	39 (76.5%)
Tucson, AZ	19	8,941	\$250 million to \$1 billion	6 (11.8%)
Prescott, AZ	11	2,472	\$1 billion to \$10 billion	5 (9.8%)
Yuma, AZ	9	1,111	> \$10 billion	1 (2%)
Flagstaff, AZ	8	783		